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BEFORE THE ARIZONA CORPORATION COMMISSION

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Commissioner
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7 IN THE MATTER OF THE APPLICATION OF)
MIDVALE TELEPHONE EXCHANGE, INC.)
8 FOR AUTHORITY TO INCREASE RATES AND)
FOR DISBURSEMENTS FROM THE ARIZONA)
9

DOCKET NO. T-02532A-00-0512

10
11 The Arizona Corporation Commission Staff ("Staff") hereby files its Initial Post
12 Hearing Brief in this matter.

13 RESPECTFULLY SUBMITTED this 3rd day of July, 2001.

14
15 Arizona Corporation Commission

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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 WILLIAM A. MUNDELL
CHAIRMAN

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COMMISSIONER

4 MARC SPITZER
COMMISSIONER

5
6 IN THE MATTER OF THE APPLICATION)
7 OF MIDVALE TELEPHONE EXCHANGE,)
8 INC. FOR AUTHORITY TO INCREASE) DOCKET NO.
9 RATES AND FOR DISBURSEMENT FROM) T-02532A-00-0512
10 THE ARIZONA UNIVERSAL SERVICE)
11 FUND)

12 **INITIAL POST-HEARING BRIEF OF COMMISSION STAFF**

13 **I. INTRODUCTION**

14 On July 20, 2000, Midvale Telephone Exchange, Inc. ("Midvale" or the
15 "Company") filed an application for authority to increase its intrastate rates, for
16 disbursement from the Arizona Universal Service Fund and for extension of its
17 Certificate of Convenience and Necessity to include new service areas. Midvale is an
18 independent local exchange carrier that provides local exchange service and other
19 telecommunications services to the Young and Cascabel exchanges.¹

20 Midvale submitted its Application using three alternative revenue requirement
21 scenarios, all based upon a 1999 test year. Its first alternative, the "Base Case", is a
22 traditional test year adjusted for known and measurable changes. Under the Base Case,
23 the Company is requesting a net increase in revenue requirement of \$108,955 per year.
24 (Ex. A-5 at p. 3). Midvale requests annual Arizona Universal Service Support ("AUSF")
25 payments of \$130,329 to meet its Base Case revenue requirement. (*Id.* at p. 4).

26 The Company's second alternative, the "EAS Case", assumes implementation of
27 extended area service ("EAS") from Midvale's Cascabel exchanges to Qwest's Benson

28 ¹ Midvale purchased the Young exchange from U S WEST Communications in 1994.

1 and San Manuel exchanges in addition to the Base Case. Under this alternative, the
2 Company's proposed net increase in revenue requirement would be \$144,706 per year.
3 (Id. at p. 3). If EAS is authorized, Midvale requests annual AUSF payments of
4 \$225,567 to meet its revenue requirement under this scenario. (Id. at p.4).

5 The Company's third alternative, the "Unserved Areas Case", assumes that
6 Midvale will extend service to two currently unserved areas, known as Millsite and Silver
7 Bell, in addition to the EAS Case. Under this alternative, the net revenue requirement
8 increase the Company requests is \$181,991 on an annual basis. (Id. at p. 3). Finally,
9 Midvale seeks annual AUSF payments of \$221,360 to meet its revenue requirement
10 under this final alternative. (Id. at p. 4).

11 Under each of its three alternatives, the Company's proposed rate design includes
12 significant rate rebalancing, including an almost 90% (78% when the elimination of zone
13 charges are included) increase in local service rates for its customers located in the
14 Young exchange, as well as a decrease in access charges. The Company also proposes to
15 eliminate any charges for custom calling features and include those features at no charge
16 with basic local exchange service in the future.

17 Staff has proposed several adjustments to Midvale's projected operating expenses,
18 rate base and cost of capital, many of which the Company has accepted. In it's Initial
19 Post-Hearing Brief, Staff will only discuss the adjustments that are disputed by the
20 Company. The most significant adjustments proposed by Staff would eliminate
21 Midvale's pro forma adjustments for EAS between Benson and Cascabel and San Manuel
22 and the Company's pro forma adjustments increasing revenue and expense accounts
23 associated with the Company's proposal to serve the two unserved areas known as
24 Millsite and Silver Bell.

25 For the reasons discussed below, Staff does not believe that the Company has
26 established a sufficient community of interest to justify EAS between Benson and
27 Cascabel and EAS between Cascabel and San Manuel. In addition, while the Staff
28 supports the Company's plans to serve two unserved areas, the pro forma adjustments

1 relating to the Company's extension of service to these areas are inappropriate in the
2 context of the current rate case since the expenses and revenues projected by the
3 Company are not "known and measurable" nor can "estimated" plant be held to meet the
4 "used or useful" standard.

5 In addition, the Company's proposal to serve these areas includes a request for
6 over \$200,000 in AUSF support which again is based solely upon estimates provided by
7 the Company, rather than actual embedded plant costs which the Rules require. See,
8 A.A.C. R14-2-1202.

9 In summary, Staff's adjustments are reasonable and would reduce the Company's
10 net annual revenue requirement increase to \$17,391. Staff's proposed rate design would
11 result in only a 38% increase in local service rates for the Young exchange and no
12 increase for customers in the Cascabel exchange. Staff's proposed rate design would also,
13 in Staff's opinion, allow the Company to extend service to the Millsite and Silver Bell
14 exchanges.

15 II. ARGUMENT

16 A. Staff's Adjustments to Pro Forma Operating Expenses, Rate Base and 17 Operating Revenues are Reasonable and Should be Adopted.

18 1. Pro Forma Adjustments Related to Unserved Areas²

19 Staff first disallowed Midvale's inclusion of estimated expenses and revenues
20 associated with its request to extend service into two unserved areas. The disallowance
21 was made in recognition of a fundamental rate making principle which demands that such
22 expenses and revenues be "known and measurable" before they are recognized in a rate
23 making context. (Ex. S-2 at p. 9; Tr. at p. 99). In that the pro forma amounts included by
24 Midvale are based solely upon estimates, they do not meet this well recognized rate
25 making standard. Staff, therefore, eliminated the pro forma adjustments related to the

26
27 ² As discussed later, Staff also removed Midvale's pro forma adjustments reducing two revenue
28 accounts in the amount of \$32,877, due to Staff Witness Allen G. Buckalew's
recommendation to deny approval of the EAS request. Should the Commission deny the
Company's request to implement EAS, it is Staff's understanding that the Company
would agree to these adjustments. See Exhibit A-4 at p. 3 ("I agree that the Staff's
adjustments are appropriate and correct if the Commission rejects EAS.")

1 Company's request to serve these areas which resulted in a decrease to six revenue
2 accounts totaling \$143,572 and a corresponding decrease to seven expense accounts
3 totaling \$183,992.

4 The "known and measurable" standard was best described by Staff Witness
5 Ahlbrecht:

6 Generally if we make an adjustment to a test year expense or revenue item,
7 it's because there has been a known and measurable change that we can
8 identify to be true at that time. In other words, for example, a change
9 perhaps in the amount they've had to pay for insurance. They have a
10 verifiable bill that shows in the time preceding since the end of the previous
11 test year, they've, in fact, had a one thousand increase that is known and
12 measurable.

13 (Tr. at p. 100). The Company's position would effectively vitiate this standard by
14 allowing any estimate, whether based upon fact or fiction, to be included in plant,
15 expenses or revenues for ratemaking purposes.

16 **2. Rate Case Expense**

17 Staff also adjusted the Company's Corporate Operations Expense by \$13,543.00.
18 Staff made this adjustment because it believes that the Company's claimed rate case
19 expenses are excessive when compared to other cases processed recently involving small
20 rural telephone companies. In addition, the Company included expenses which are
21 typically capitalized, rather than expensed, which also contributed to its inflated expenses
22 in this regard.

23 The Company claims it will have in excess of \$150,000 in expenses related to this
24 case. (Ex. A-2 at p. 6). The Company attributes this largely to what it claims was
25 excessive discovery by the Staff.³ (Ex. A-2 at pps. 4-5). Nonetheless, as Mr.
26 Williams acknowledges the Staff sent only six rounds of written discovery to the
27 Company totaling approximately 115 questions. (Ex. A-2, pps. 5-6). The scope and
28

³ See Exhibit A-2 at pps. 4-5 ("The biggest single factor in this expenditure has been the cost of responding the Staff's discovery requests"); See also Exhibit A-2 at p. 5 ("By the time we finished our responses to the Staff's discovery requests, Midvale's out of pocket costs for the rate case were already more than \$100,000, not counting the engineering costs challenged by the Staff").

1 degree of Staff's discovery in this case was consistent with that conducted recently for
2 several other small rural telephone company rate cases filed with the Commission.

3 Mr. William's statement that he has "never seen a case that even remotely rivals
4 this one for excessive costs," is greatly exaggerated and unwarranted.⁴ In other recent
5 rate cases filed by small telephone companies, the Residential Utility Consumer Office
6 had intervened and promulgated significant discovery. As acknowledged by Mr.
7 Williams on cross-examination, RUCO did not intervene in this case. (Tr. at p. 47). In
8 addition, the Company's attempts to disparage Staff for having performed an "on-site"
9 visit should be outright rejected. The Staff performed the on-site visit at the Company's
10 request in order to save the Company the time and expense of responding through formal
11 written replies and the production of documents to the final set of Staff data requests.
12 (Tr. at pps. 111-112).

13 Another factor accounting for the Company's exaggerated number, is Midvale's
14 attempt to include engineering costs that are traditionally capitalized, as a rate case
15 expense in this case. The Company's requested rate case expense includes \$41,610 in
16 engineering costs. (Ex. S-2 at p. 16). These engineering costs were related to the CC&N
17 extension and not to the rate case, however. (Ex. S-6 at p. 4). It is likely that a large
18 portion of the remaining \$108,390 is also related to the CC&N extension and not the rate
19 case. Id. It is inappropriate to treat this as a rate case expense since costs related to
20 CC&N extensions have always been capitalized instead of expensed, and the Company
21 should have been aware of this since this is the way these expenses were handled in when
22 it extended service to the Cascabel exchange.

23 This Commission has typically approved rate case expenses in the range of
24 \$60,000, amortized over three years, for cases involving small telephone utility rate
25 cases. (Ex. S-2 at p. 6). Staff believes its adjustment is reasonable and that the amount it
26 is recommending for rate case expense in this case represents a reasonable approximation
27 of the Company's costs related to the rate portion of its case.

28

⁴ Exhibit A-2 at p. 5.

1 **3. Cost of Capital**

2 The Staff recommended an 11.50 percent cost of equity capital in this case, which
3 is based on the results of Staff's cost of equity analysis, which used both the DCF and
4 CAPM methodologies. (Ex. S-3 at p. 2). Staff also recommended a cost of debt of 5.47
5 percent. Id. Staff further recommended a capital structure consisting of 22.60 percent
6 long-term debt and 77.40 percent common equity. (Id. at p. 2). Using the results of
7 Staff's analysis of capital structure, cost of debt and equity, Staff recommended a 10.14
8 percent cost of capital for Midvale. (Ex. S-3 at p. 2). This represents the weighted cost
9 of both the Company's debt and equity. (Id. at p. 2).

10 The Company, on the other hand, has proposed a return on equity of 13.0%, a
11 weighted cost of debt of roughly 5.5%, a ratio of approximately 24% debt to 76% equity
12 and a weighted overall cost of capital of 11.2%. (Id. at p. 8). In order to arrive at the 13
13 percent cost of equity, the Company used both a market approach and a comparable
14 earnings approach, according to Company Witness Reading. (Ex. A-3 at p. 10).

15 Midvale's weighted cost of capital is based upon some underlying faulty
16 assumptions as well as a mathematical error which was pointed out to Company Witness
17 Reading on cross-examination who in response appeared to move away from his original
18 analysis by attempting to nonetheless justify the same result (inclusive of the error) as
19 being based upon risk. (Tr. at p. 84). The error can be found at Exhibit 2, Schedule D-4,
20 p. 17, appended to Exhibit A-3, where Company Witness Reading details the results of
21 his cost of capital analysis using the DCF method (10.9% to 12.25%), the comparable
22 earnings method (12.0% to 14.0%) and the risk premium method (12.5% to 14.5%). Dr.
23 Reading's prefiled testimony at p. 11 however, states that the estimate of the cost of
24 equity capital would be between 11.0 to 12.2 percent; and 12.25% based upon the risk
25 premium approach; which Dr. Reading acknowledged at the hearing was in conflict with
26 his earlier testimony at p. 17. (Tr. at p. 77). Correcting for this mathematical error in the
27 risk premium result would actually produce a mid-range estimate of 11.60 percent, as
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1 opposed to the 13 percent recommended by Dr Reading, which is very close to Staff
2 Witness Reiker's recommendation. (Tr. at p 78).

3 In addition, the Company also relied heavily upon its belief that it faces a higher
4 level of risk than the average telephone company which Company Witness Reading then
5 claims justifies a higher than average rate of return. (Ex. A-3 at p. 10). Dr. Reading
6 detailed the nature of this risk in the following passage from his Direct Testimony:

7 Formerly, the portion of revenues required from local exchange services
8 was held down by the higher contribution levels obtained from the
9 interstate jurisdiction. Now, with interstate access charges moving steeply
10 down, a higher percentage of network costs must be recovered locally,
11 where swings in economic conditions can strongly impact telecom
12 revenues. Furthermore, whereas companies like Midvale once enjoyed
13 local monopolies, they are now subject to competition from other carriers,
14 both wireline and wireless. Prior to the development of significant
15 competition, telephone carriers and most other public utilities faced
16 relatively minimal risks from unpredictable changes in the business cycle
17 and other forces that cause industry demand to fluctuate. New telephone
18 carriers are facing increasing levels of competition, especially for their
19 higher margin business, customers, and their "recession proof" earnings can
20 be eroded even during periods of the greatest prosperity. ...

21 (Ex. A-3 at pps. 10-11).

22 Yet, when cross-examined on these points, Company Witness Reading readily
23 acknowledged that Midvale faces no competition at this time⁵ and that recent actions by
24 the FCC in its Universal Service Proceeding, Docket No. 96-45, pertaining to rural
25 telephone companies such as Midvale will actually result in maintenance of current levels
26 of interstate support for several years. (Tr. at p. 69).⁶

27 One other point bears reiteration. Dr. Reading also disparages the Staff's analysis
28 because he claims that larger local exchange carriers are less risky than Midvale. While
29 Dr. Reading provides no basis for this claim, as Staff Witness Reiker pointed out in his

⁵ Tr. at p. 76 (Q. "How many competitive carriers are there operating in Midvale's service territories?" A. "None that I know of.").

⁶ (Q. "But based upon your reading of the order, it is your opinion overall that the FCC's recent universal service ruling adopting the Rural Task Force recommendation would benefit and provide some security to a telephone company such as Midvale?" A. "Yes.").

1 Surrebuttal Testimony, it is Midvale's capital structure, cost of debt and concentration in
2 the local telephone industry that contribute to a lower cost of equity than the comparable
3 companies. (Ex. S-7 at p. 7). Moreover, Midvale certainly has little reason to complain
4 in that its comparable earnings analysis relies solely on unregulated industrial and
5 manufacturing firms, which results in excessive cost of equity results for the Company.
6 (Ex. S-7 at p. 10). The mid-range of Company Witness Reading's DCF and risk
7 premium approaches is 11.58 percent and 11.63 percent respectively. (*Id.*)

8 In summary, the Company's request for a 13.00 percent cost of equity is
9 excessive. The Commission has consistently accepted the results of the DCF
10 methodology as used by Staff. That analysis and the DCF analysis of the Company's
11 own witness show that an 11.50% cost of equity for Midvale is fair and reasonable. (Ex.
12 S-7 at p. 10).

13 **B. Midvale's Application for Extended Area Service Should be Denied**
14 **Because the Record Contains Insufficient Evidence of a Community of**
15 **Interest.**

16 The Company's second alternative case, which it calls the "EAS Case", includes
17 the Base Case plus its proposal to establish EAS between Midvale's Cascabel exchange
18 and Qwest's Benson and San Manuel exchanges. (Ex. A-5 at p. 2).⁷

19 Staff recommends that the Commission deny the Company's request for several
20 reasons. First, Midvale has provided no evidence that EAS is in the public interest.
21 Staff's analysis and the Commission's consideration has in the past revolved around the
22 establishment of a community of interest. See Re U S West Communications Inc., 1995
23 WL 39883 (Ariz.C.C.), Docket No. E-1051-93-183, Decision No. 58927 (1995). The
24 factors considered in determining community of interest are public input, call volume and
25 direction, socio-economic links, and contiguity. (*Id.*) Midvale has not provided any
26 socioeconomic studies that would demonstrate that there is a community of interest
27 between the exchanges for which EAS is proposed. (Tr. at p. 64). Company Witness

28 ⁷ In its Application and original testimony, the Company refers to the "San Miguel" exchange.
Staff assumes that the Company actually meant the "San Manuel" exchange.

1 Reading admits that no customer surveys or market analysis was performed to ensure
2 customers actually want and need EAS. (Tr. at p. 64). Further, the only evidence in the
3 record of activity between the proposed EAS sites of Cascabel to Benson and Cascabel to
4 San Manuel are contained in Midvale's response to data requests submitted by Qwest.
5 The data provided Qwest was summarized by Dr. Reading during cross-examination and
6 reflects a low volume of calls, 2.5 calls per line per month from Cascabel to San Manuel
7 and 6.5 calls per line per month from Cascabel to Benson. Id. at pps. 60, 66. As few as
8 2% of customers in Benson and San Manuel place a call to Cascabel during any given
9 month. (Tr. at pps. 40-41). The Company's traffic studies also demonstrate that very
10 few customers make most of the toll calls; less than 20% of its customers in Cascabel
11 make most of the calls to San Manuel or Benson. (Ex. S-4 at p. 19).

12 Second, all consumers in those exchanges and Arizona would be paying for the
13 service. And, the establishment of EAS in this case is a very expensive proposal.
14 Midvale is asking the Commission to approve AUSF funding, that will come from all
15 consumers throughout the State of Arizona, and will result in a subsidy of \$40 a month
16 per customer. Midvale is effectively asking for AUSF of almost \$40 per line to fund its
17 EAS proposal. (Ex. S-4 at p. 19). Staff believes to ask all Arizona consumers to finance
18 these two EAS routes when only 20% of Midvale's customers make the majority of calls,
19 is unreasonable. Further, Staff does not believe that the Commission ever intended
20 AUSF to be used to fund toll services, which is essentially the result since what were
21 previously toll routes would be converted to EAS routes where toll calls would no longer
22 be necessary.

23 Third, it is important to recognize that Midvale's customers do have options today.
24 Company and Staff witnesses testified that there are alternative calling plans offered by
25 interexchange carriers and Qwest on these two routes. (Ex. S-4 at p. 20; Tr. at p. 42).
26 Midvale could also offer optional calling plans in the future.

1 Finally, as conceded by Witness Williams on cross-examination, where there are
2 overlapping EAS areas, as in this case, there is a potential for EAS fraud or bridging and
3 that the Commission should take this into consideration. (Tr. at p. 34).

4 For all of the foregoing reasons, Staff recommends that the Commission deny
5 Midvale's request for EAS.

6 **C. Staff's Rate Design is Reasonable**

7 Midvale proposes to increase basic residential exchange rates in the both the
8 Young and Cascabel exchanges to \$24.00 and basic business exchange rates in the
9 Cascabel exchange to \$32.00. (Ex. A-5 at p. 3). Current residential rates in the Young
10 exchange are \$12.40 and in the Cascabel exchange are \$21.00. (Ex. S-4 at pps. 20-21).
11 Business rates in the Young exchange are currently at \$32.00 and in the Cascabel
12 exchange, they are at \$21.00. The Company proposal would increase basic rates for
13 customers in the Young exchange by 94 percent and for customers in the Cascabel
14 exchange by 14 percent. (Ex. S-4 at p. 20). Business rates in the Cascabel exchange
15 would increase by 65%. Midvale has proposed this particular rate design to standardize
16 the local rates in both exchanges at \$24.00 per month for residential customers and \$32
17 for businesses. (Ex. A-5 at pps. 3-4).

18 The Company is also proposing reductions to access charges assessed to
19 interexchange carriers in both exchanges to \$.06 per minute. (Ex. A-5 at p. 4). The other
20 significant changes proposed by the Company included elimination of charges for custom
21 calling and zone charges.

22 While Staff does not necessarily oppose standardization of rates between the
23 exchanges, the Staff is concerned that the Company's proposal would result in rate shock
24 to subscribers in the Young exchange. Indeed, approximately 250 Young customers
25 signed a petition objecting to the 94 percent increase in residential rates proposed by the
26 Company. (Tr. at p. 11). Staff proposes to accomplish such standardization in steps, and
27 therefore, Staff has proposed a rate for residential customers in the Young exchange of
28 \$17.15. The residential rate in Cascabel would remain at 21.00. (Ex. S-4 at p. 22).

1 Another benefit of Staff's proposed rate design is that the proposed increases would not
2 result in the need for any AUSF funding.

3 Staff also disagrees with the Company's proposal to eliminate charges for custom
4 calling features. Custom calling is not part of basic service and should have a separate
5 charge. (Ex. S-4 at p. 23). Staff believes that the demand for these services is low which
6 may be due to the high rates for these services currently being charged. (Ex. S-4 at p. 23).
7 Since all parties agree that the actual costs of custom calling features are very low, Staff
8 has recommended a reduction to these rates to \$2.00 which would still cover the
9 Company's costs and which should encourage more usage. (Id. at p. 23).

10 In summary, Staff's proposed rate design is reasonable and should be adopted.
11 Midvale does not object to the Staff's proposed rate design for Young and Cascabel. (Tr.
12 at p. 49).

13 **D. In Accordance with the Existing AUSF Rules, Midvale's Request for**
14 **AUSF Should be Reconsidered When Its Actual Costs to Extend**
15 **Service Are Available.**

16 Midvale, in its Application, has proposed to extend service to two new exchanges
17 comprising Millsite, Henderson Valley, Rio Verde and Silver Bell, all of which are
18 currently unserved. Staff supports bringing service to these areas and commends the
19 Company for its willingness to serve both areas. Staff supports the Company's request to
20 extend service into all of these areas even though it would probably be more
21 economically and operationally feasible for Qwest to serve them, in particular the
22 remaining Rio Verde area.

23 There are two points of disagreement between the Company and Staff concerning
24 the Company's request. One was discussed earlier and relates to the Company's proposal
25 to include its estimated and hypothetical costs to extend its network in its rate case when
26 those costs are not known or measurable. The second point of disagreement concerns the
27 Company's request for immediate AUSF assistance to serve these areas.

1 The Company has used estimated costs as the basis for its application which
2 would result in a significant increase in rates for its own customers, as well as an increase
3 in rates for all other Arizona consumers. The Company estimates that the number of
4 customers served by it in these exchanges is approximately 200 for the Millsite exchange
5 and approximately 185 customers for the Silver Bell exchange. (Ex. S-4, p. 11). To do
6 this, the Company expects to invest approximately \$1.45 million dollars and requests
7 \$221,306 annually from the AUSF to support its Alternative 3 unserved area scenario.
8 (Ex. S-4, p. 11).

9 The problem from Staff's perspective is that the existing AUSF rules require a
10 Company to submit more than merely "estimated" or "hypothetical" costs in order to
11 receive AUSF assistance. It is not Staff's position that the Company is not entitled to
12 AUSF if it actually ends up serving these areas or that it should never receive AUSF. It
13 is more a matter of timing than anything else.

14 The current rules are clear that AUSF support has to be based on something more
15 than an engineering study and an estimate of the costs to provide service in any given
16 area. A.A.C. R14-2-1202, subpart B, states in relevant part:

17 "For a small local exchange carrier, the AUSF support area shall include all
18 exchanges *served* by the local exchange carrier in Arizona. The appropriate cost of
19 providing basic local support for a small local exchange carrier shall be the
20 *embedded cost* of the incumbent provider." (emphasis added).

21 The first sentence of the rule clearly contemplates that the area is already currently
22 *served* by the provider. This reading does not allow application for funds for an area the
23 provider is proposing to serve. Midvale does not currently serve these areas.

24 The second sentence requires that the cost of providing service be computed from
25 the *embedded costs* of the carrier. Embedded costs are generally recognized to be the
26 historical or sunk costs recorded by the incumbent provider. Pro forma or estimated costs
27 are based on assumed or anticipated facts.

28 This reading is also supported by A.A.C. R14-2-1203 which states that a provider
of basic local exchange telephone service may request that the Commission authorize

1 AUSF support with a filing under R14-2-103, which is a traditional rate case. Under
2 well-established utility law principles, expenses must be “known and measurable” and
3 plant must be “used and useful” before it is recognized for rate case purposes.
4 Engineering studies which contain estimates of the costs to provide service in an area and
5 estimates of expenses to serve these areas simply cannot be found to reasonably meet
6 either of these standards.

7 Arizona rules also require that AUSF support be “net of any universal service
8 support from federal sources.” A.A.C. R.14-2-1202.A. The implication is that federal
9 sources are to be pursued and quantified before application for AUSF. AUSF is to
10 supplement Federal Universal Service Funds (“FUSF”), not the other way around.

11 Midvale mischaracterizes Staffs adherence to the rules as Staff looking for ways to
12 frustrate the goals of AUSF. (Tr. at p. 134). Staff’s adherence to the rules does not
13 frustrate, but instead creates a logical sequence for application by a company to receive
14 AUSF funds.

15 Midvale also argues that absent AUSF support, it would have to raise both access
16 charges and local rates to levels that may be in excess of the customers’ ability to pay.
17 (Ex A-1 at p. 5). But, the record in this case does not bear this out. The Company did a
18 survey of four different subdivisions and found that anything over a \$25.00 local rate
19 may be in excess of the customer’s ability or willingness to pay. (Tr. at p. 49). Staff has
20 proposed residential local exchange rates of \$24.00 and business local exchange rates of
21 \$30.00. (Ex. S-4, p. 12). All other rates, including custom calling and access charges,
22 would be the same as Staff’s recommendation for the existing service areas. (Id.)

23 Staff’s proposed rates are based upon an annual revenue requirement, calculated
24 from the estimated cost that the Company has filed with regard to the unserved areas.
25 (Ex. S-4 at p. 12). This does not assume the full amount of Federal universal service
26 funds that the Company is expected to receive for these areas. (Ex S-4 at p. 12). If
27 Federal universal service funds equal to those received by the Company for the Young
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1 exchange are factored in, the local exchange rate would be lower and closer to the
2 Company-wide rates. (Ex S-4 at p. 12).

3 The Company has two concerns with the Staff analysis in this regard. First, the
4 Company takes issue with the amount of Federal universal service support Staff has
5 projected for these areas. Currently, the Company receives \$328,874 per year in Federal
6 support.⁸ This equates to \$43.50 per access line per month from the FUSF. However, in
7 an attempt to be conservative, Staff assumed that the new customers in the unserved areas
8 would receive only about one-half that amount, or about \$21.50 per month. In reality, the
9 Company is likely to receive \$43.50 per customer per month, or more, because the
10 unserved areas' costs are higher than Midvale's costs. Midvale objects to the inclusion of
11 \$21.50 per line per month of FUSF and suggests that it should initially be set at zero
12 because it does not believe that it will be receiving FUSF at the time the plant is placed
13 into service. Staff does not agree with this assumption.

14 Under existing FCC rules, embedded plant must actually be in place for two years
15 before application for FUSF support. See 47 C.F.R. Sections 36.611 and 36.612. Carriers
16 can apply to the FCC for waiver of this rule, however, and such waivers have been
17 granted in the past. See, In the Matter of Border to Border Communications, Inc.,
18 Memorandum Opinion and Order, 10 F.C.C.R. 5055 (1995) (granting waiver of 47
19 C.F.R. §§ 36.611 and 36.612 embedded cost requirements for calculation of FUSF
20 support). It will take Midvale considerable time to build out their plant to provide service
21 to these areas. (Tr. at p. 170). Staff believes that there will certainly be sufficient time
22 before the Company actually begins providing service, for Midvale to submit its request
23 to the FCC and for a determination by that agency. Instead the Company is urging that
24 the Commission simply trust its estimates and assume that no FUSF will be received.

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28 ⁸ See Midvale Exhibit 2, Schedule C-1 which shows that the Company currently receives
\$107,050 of Federal support and that is being increased by \$221,824 because the FCC
recently granted a request for waiver by Midvale which removed the cap on FUSF the
Company could receive. See Exhibit A-3 at p. 7.

1 The likelihood of the Company's waiver petition being denied by the FCC or the
2 likelihood of its not receiving support by the time it is ready to serve customers is belied
3 by the following passage from the FCC's recent South Park Telephone decision:

4 8. South Park is a new telephone company seeking to provide
5 telephone service to rural customers in a previously unserved area.
6 Initially, South Park will provide service to 81 customers. To enable
7 its provision of service, South Park seeks to participate in the NECA
8 tariff and to receive high cost loop support immediately. South Park
9 however, as a new company, has no historical cost data. Because the
Commission's rules require calculation of high cost loop support
disbursements to be based on historical cost data, South Park would be
precluded from receiving high cost loop support until 1999.

10 9. In a previous proceeding, the Division granted an incumbent LEC a
11 waiver of sections 36.611 and 36.612 permitting it to receive high cost
12 loop support immediately using current costs rather than the required
13 historical costs because the carrier was a new company that had begun
14 to serve a previously unserved territory and the area would likely have
15 remained without service if the carrier were unable to provide service.
16 In that proceeding, we found compelling reasons to permit immediate
high cost loop support for a new company providing service to an
unserved area. ...⁹

17 The FCC's policy was best described in a case where it denied a request for
18 waiver submitted by Fremont Telecom Company:

19 It has been long standing policy not to waive sections 36.611 and
20 36.612 of the Commission's rules. In fact, we have granted waiver
21 of these sections only when a requesting carrier proposes to serve or
is serving previously unserved areas.¹⁰

22 Waivers of the 24 month rule for unserved areas are routinely granted by the FCC
23 to further the Telecommunications Act mandates to promote universal service.¹¹ Staff's
24 assumptions concerning Midvale's likelihood of obtaining a waiver and FUSF funds are
25

26 ⁹ See Border to Border Communications, 10 FCC Rcd 5055 (1995) and South Park Telephone,
27 AAD 97-41, DA 97-2730 (rel. December 31, 1997).

28 ¹⁰ See In Re Fremont Telecom Company, 1998 WL 808445 AAD 97-56, (rel. January 23, 1998).

¹¹ See also CC Docket No. 96-45, (rel. January 18, 2001).

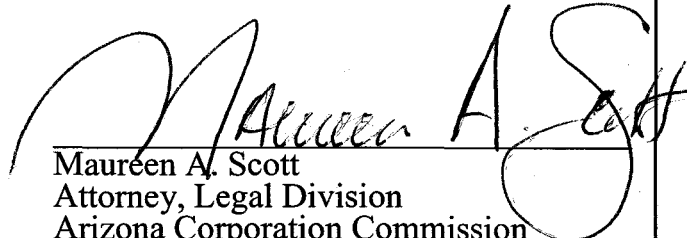
1 reasonable; assuming no FUSF funding or that the waiver will not be granted in this case
2 is not reasonable in Staff's opinion.

3 Staff believes that given FUSF support and cost and revenue sources for the
4 unserved areas, no AUSF will ultimately be required by Midvale. (Tr. at p. 162). The
5 Company's own witness, Dr. Reading, states it is a near certainty that Midvale will
6 ultimately receive FUSF funding. (Tr. at p. 84). However, once the plant is in place, and
7 if the improbable happens and the Company receives no FUSF, Staff would recommend
8 that the Commission reconsider the Company's request for AUSF.

9 **III. CONCLUSION**

10 For the foregoing reasons, Staff respectfully requests that the Hearing Division
11 issue an Order consistent with the Staff's recommendations in this case.

12
13 RESPECTFULLY SUBMITTED this 3rd day of July, 2001.

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